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Washington, D.C. 20520

Date December 4, 1980

Control No. 8025057 thru 8025065

TO : S/S - Mr. Bremer

SUBJECT: Transition Papers

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Thanks

EK

Elijah Kelly

Action

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REVIEWED BY Ann Baister DATE 5/23/85

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CONFIDENTIAL
MEMORANDUM

December 3, 1980

TO: S/RTT - Mr. Rashish

FROM: EB - Ernest Johnston, Acting E.J.

SUBJECT: Transition Papers

Attached are the transition papers you requested for today:

International Economic Policy 25065
US Grain Trade with the USSR 25064
US International Commodity Policy 25063
The Future of the MTN Subsidies Code 25062
Wheat Trade Convention 25061
Japanese/US Civil Aviation Talks 25060
Poland: The Economic Dimension 25059
Economic Issues in US-Canadian Bilateral Relations 25058
LDC Debt 25057

I still owe you two papers:

Textile Policy
Economic and Business Affairs Bureau -
Legislative Issues

We have stayed close to your maximum limits but the legislative paper will be more extensive. I will get the two remaining papers to you tomorrow morning.

cc: S/S - Mr. Tarnoff

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GDS 12/3/86

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BRIEFING PAPER

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TRANSITION PAPER - LDC DEBT

Issue

Since the 1973 oil shock, the financing requirements of developing countries have increased dramatically, both in absolute terms and relative to their GNP growth. Different patterns of indebtedness have emerged among these countries, as higher-income LDCs have had access increasingly to private sources of external funds, while lower income countries have relied on official assistance flows. As the LDC debt burden expands, the number of countries experiencing debt problems has increased and the nature of those problems has changed. Official debt now accounts for a minor share of total external debt in many debt problem countries. Most of these cases reflect short-term financial crises which can be treated effectively within established international institutions and procedures. However, some LDCs have longer-term, structural debt problems, resulting from unwise use of borrowed funds or insufficient adjustment efforts. To encourage economic adjustment and improved financial discipline in such cases, a different attitude toward debt relief may be required.

While both the magnitude and pattern of LDC indebtedness has changed over the past 5-7 years, U.S. debt policy has remained largely unchanged. Constrained by close Congressional oversight, the USG has addressed debt problems with a short-term, crisis management approach. Strict financial criteria guide the U.S. approach to debt rescheduling operations, which are seen as last-ditch efforts to be used only in cases of imminent or actual default. This approach has been successful for many short-term debt problem cases, but it has failed to resolve the chronic debt problems faced by some countries (e.g. Turkey, Zaire) and cannot address the adjustment/growth trade-off facing countries which borrow predominantly from the private sector (e.g. Jamaica, Brazil, Poland).

Background

The debt outstanding of developing countries grew at an annual rate of about 20% per year during the 1973-1980 period, and reached an estimated level of $410 billion by the end of the period. While this appears extremely large compared to the level of $114 billion in 1973, much of the dollar-value increase is due to inflation. Nonetheless, total indebtedness grew in real terms at a rate of 6.8% per annum during the period, compared to an annual growth rate of 5.3% for the GDP of the developing world, and 5.1% per year growth in the volume of

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exports. Thus, debt outstanding in 1980 was both absolutely and relatively higher than in 1973. Total debt outstanding for oil-importing LDCs reached 22% of their GNPs at the end of 1978, compared to 17% in 1973. The debt service ratio (debt payment obligations compared to total export earnings) for these countries increased from 19.6% in 1973 to 22.3% in 1978 and is projected to continue increasing through 1985, reaching 26.0% (see tables 1-3, attached). It is worth noting, however, that the debt service ratio for lower income LDCs actually fell from 1974 to 1978, due in part to the limited availability of official development assistance.

Highly aggregated figures, such as those cited above, indicate broad trends for LDCs, but also hide important developments for individual countries and do not distinguish different patterns of borrowing among groups of LDCs. Debt service problems are essentially country problems; for example, from 1974 to 1979, Turkey's debt service ratio rose from 6.7% to 29.9%, Morocco from 5.9% to 24.8%, and Brazil from 34.5% to 61.7% (see Table 4). In addition, higher income LDCs have relied increasingly on private sector borrowing. These funds usually carry harder terms (e.g. higher interest rates and shorter repayment periods) than official credits available mainly to lower income LDCs.

A review of recent debt problem cases illustrates both the similarities and differences between various countries, and the interrelationships between debt and other problems. After 1973, the higher cost of oil and other imports brought on larger balance of payments deficits. Some countries were able to finance this deficit in private capital markets, due in part to high liquidity in these markets and weak OECD demand for financing. A sudden downturn in primary commodity prices (Philippines, Zaire) or a decline in export volumes (Peru, Sudan) imperiled creditworthiness. In the case of Turkey, a decline in worker's remittances, weak exports of manufactures and serious overborrowing in the short-term Eurocurrency market provoked the 1978 crisis. In Sudan, a decline in official aid exacerbated the existing problems.

Many governments used external borrowings to avoid a reduction in either their planned investment programs or in consumption levels. In certain cases, foreign borrowings were not devoted to the kinds of activities that would create an eventual repayment capacity or reduce dependence on imports. On the side of private creditors, risk asessment for sovereign borrowers was not well developed and some loans were made without regard to the appropriateness of the terms, the financial condition of the borrower, or the long-run outlook for repayment.

Debt has been a key issue in the North-South dialogue since the economic impact of the first oil crisis hit the LDCs in 1974. The LDCs have insisted on some means to alleviate their debt burden - up

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to and including a generalized moratorium on public and private debt payments. These discussions led to two landmark decisions in the UNCTAD context: in 1978, the developed donor countries agreed to seek necessary legislation to provide "Retroactive Terms Adjustment" to the poorest countries; in September 1980, the U.S. agreed to a resolution adopting guidelines for debt relief operations and inviting the IMF and IBRD to provide economic analysis in support of debt relief operations.

Time Constraint

One spin-off from the September UNCTAD resolution is that we will be required to re-examine our attitude toward the role of the IMF and IBRD in debt rescheduling operations. A major IMF study of debt problems of LDCs will be discussed by the IMF Board in January - by which time our internal review of the IMF role must be complete.

Recent debt problem cases have resulted in numerous exceptions of one form or another to stated U.S. debt policy. While no immediate general policy decision is required, the frequency of exceptions in individual cases suggests that high-level decisions may be required at any time on cases such as Nicaragua, Pakistan, Liberia, Zaire and Turkey.

What We Are Doing and Why

Current U.S. policy on debt rescheduling is most succinctly defined in the attached policy statement; the three basic elements of that statement indicate our strict financial approach to debt crises. Those elements are:

1) that debt relief be granted only in extreme cases where the debtor country's financial situation precludes timely repayment (e.g. imminent default);

2) that debt relief be conditioned on the implementation of a meaningful economic stabilization program designed to improve the debtor country's future ability to service its debts; and

3) that debt rescheduling be conducted in a multilateral framework to ensure equitable burdensharing by all creditors.

Our financial approach is based in part on a policy stance, required by Congress, that debt relief not be viewed as development assistance. However, the requirement that debt relief be granted only in imminent default situations reduces the effectiveness of

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debt relief as a policy tool in non-crisis cases. For lower-income LDCs with long-term structural problems (e.g. Pakistan, India), the imminent default criteria may not be met, yet the ongoing debt service burden can represent a serious impediment to economic adjustment. Higher income LDCs, heavily dependent on private capital markets, must virtually reach collapse before official relief is granted. By this point, the countries' creditworthiness has been damaged, jeopardizing further access to private markets.

In contrast, the requirement for a meaningful economic stabilization program as part of a debt relief operation enhances the ability of debtor countries to adjust to new conditions in the international economic system and avoid more serious debt problems. In practice, this policy has translated into the requirement for an upper tranche IMF stand-by or extended arrangement. The IMF has broadened its economic perspective, and is an effective institution for monitoring the medium-term adjustment programs associated with debt relief. For countries with longer-term structural debt problems, the World Bank programs and new assistance may be better designed to assist them.

At the operational level, we are preparing a position paper for use by the U.S. Executive Directors to the IMF and IBRD when the Boards of these institutions discuss their respective response to the UNCTAD Resolution. The Congress authorized in 1979 U.S. participation in "Retroactive Terms Adjustment", but required annual appropriation of the payment reflows effectively converted to grants. No appropriations have yet passed the Congress.

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Table 1: DEBT OUTSTANDING AS A PERCENT OF GNP

	1973	1974	1975	1976	1977	1978
Oil Exporters	19.8	17.0	19.5	23.9	26.8	29.4
Oil Importers	17.3	17.0	18.6	19.1	20.1	22.0
Low Income	17.6	17.0	18.2	20.1	19.9	19.4
Middle Income	17.3	16.9	18.8	18.9	20.2	22.8

Table 2: DEBT SERVICE RATIOS
(percent)

	1974	1975	1976	1977	1978
Oil Exporters	9.3	11.4	12.9	16.0	21.4
Oil Importers	19.6	22.5	20.8	21.2	22.3
Low Income	13.5	13.1	11.6	10.1	10.3
Middle Income	18.4	22.1	20.2	20.3	24.8

	1977	1980	1985	1990
Oil Importers	21.2	22.9	26.0	20.7
Low Income	10.1	9.1	11.3	11.5
Middle Income	20.3	25.7	28.6	22.1
Oil Exporters	16.0	15.4	13.5	12.9

Source: EPD (36 country sample). IBRD

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Table 3: DEBT OUTSTANDING AND DEBT SERVICE
($ millions)

	1973	1975	1977	1978	1980 (est.)	Growth Rate (%) 1973-80
Debt Outstanding & Disbursed						
Oil Exporters /a	27,056	44,032	73,891	94,051	124,972	24.4
Oil Importers	86.097	127,400	183,561	224,140	285,000	18.6
Low Income	20,112	25,722	32,576	36,353	43,023	11.5
Middle Income	65,985	101,678	150,985	187,787	241,977	20.4
TOTAL	113,153	171,432	257,452	318,191	409,972	20.2
Deflator (IPI)	63.4	91.1	100.0	115.9	144.9	12.5
Total in 1977 Dollars	178,475	188,180	257,452	274,539	282,934	6.8
Debt Service						
Oil Exporters /a	3,136	5,936	11,154	15,825	18,744	29.1
Oil Importers	8,038	19,203	26,691	36,409	49,711	29.7
Low Income	1,189	1,641	1,852	2,183	3,305	15.7
Middle Income	6,849	17,562	24,839	34,226	46,406	31.4
TOTAL	11,174	25,139	37,845	52,234	68,455	29.6
Deflator (IPI)	63.4	91.1	100.0	115.9	144.9	12.5
Total in 1977 Dollars	17,625	27,595	37,845	45,068	47,243	15.1

/a Excludes capital surplus oil exporters.

Source: External Debt Division, EPD, and WDR projections. IBRD

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Table 4: DEBT SERVICE RATIOS FOR SELECTED COUNTRIES, 1974-79
(Percent)

	1974	1975	1976	1977	1978	1979
I. Oil Importers						
Low Income						
Bangladesh	5.5	16.3	12.7	10.2	11.7	12.0 e
Ethiopia	5.4	7.4	6.7	6.4	7.5	6.6 e
India	17.4	13.0	10.8	9.6	9.8 e	8.7 e
Kenya	8.0	11.5	12.0	8.6	14.7	11.6
Madagascar	3.6	3.3	3.9	3.4	3.2	6.6 e
Pakistan	14.5	15.4	15.4	13.7	12.3	12.9
Sri Lanka	12.0	21.8	20.0	14.5	9.2	6.9
Tanzania	6.6	7.7	5.8	6.4	7.1	7.2 e
Middle Income						
Argentina	25.4	38.4	30.7	25.2	37.5	27.0
Brazil	34.5	40.8	36.7	40.4	51.9	61.7
Chile	18.2	39.6	39.1	43.6	46.3	36.3
Colombia	21.3	14.4	12.6	11.2	11.9	12.3
Ghana	4.4	6.2	6.4	4.1	5.2	13.6 e
Guatemala	4.7	2.7	5.9	4.0	6.5	7.8
Ivory Coast	14.3	15.4	14.4	14.2	18.4	23.3 e
Korea	11.0	12.4	10.4	9.9	11.3	12.1
Morocco	5.9	6.1	7.9	11.7	20.0	24.8 e
Peru	35.5	41.2	44.9	46.8	45.5	40.8
Philippines	12.0	12.8	14.6	14.2	26.6	15.2
Senegal	6.3	5.9	6.0	6.6	15.7	15.4 e
Sudan	14.2	21.7	14.1	7.5	9.4	32.6
Thailand	9.1	12.6	10.9	10.5	15.6	9.3
Turkey	6.7	8.0	10.9	22.1	27.1	29.9
Yugoslavia	17.2	18.6	17.1	13.5	12.3 e	16.6 e
Zambia	8.4	13.3	13.6	22.2	34.9 e	28.4 e
II. Oil Exporters						
Algeria	14.5	9.5	14.1	16.4	22.1	25.7 e
Bolivia	18.5	24.2	24.4	30.3	60.3	40.6
Ecuador	8.4	5.4	8.4	8.7	13.2	30.9
Egypt	21.7	22.5	18.5	24.1	22.2	18.3
Indonesia	5.7	9.5	11.9	15.5	17.4	24.0
Malaysia	3.7	4.7	5.8	7.7	9.5	4.8
Mexico	29.1	37.1	43.2	55.6	60.7	71.2
Nigeria	1.9	3.0	3.6	1.2	1.9	1.8 e
Syria	6.4	7.9	7.7	7.2	16.0	13.6 e
Tunisia	6.7	6.9	7.1	12.3	13.5	17.9 e
Venezuela	5.4	6.9	6.0	10.2	9.6	11.3

Notes: Debt service ratio = total debt service, divided by exports of total goods and services; e = staff estimates.
Source: Economic Analysis and Projections Department. IBRD

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Action 78-5
January 6, 1978

National Advisory Council

On International Monetary and Financial Policies

Subject: Proposed Policy Statement on Debt Reorganization

Action:

The National Advisory Council advises the Secretary of the Treasury that it approves the following proposed policy statement on multilateral debt reorganizations:

1. Debt-service payments on international debt should be reorganized on a case-by-case basis only in extraordinary circumstances where reorganization is necessary to ensure repayment. Debt relief should not be given as a form of development assistance.

2. Debt-service payments on loans extended or guaranteed by the U.S. Government will normally only be reorganized in the framework of a multilateral creditor-club agreement.

3. When a reorganization takes place that involves government credits or government-guaranteed credits, the U.S. will participate only if:

(a) the reorganization agreement incorporates the principle of non-discrimination among creditor countries, including those that are not party to the agreement;

(b) the debtor country agrees to make all reasonable efforts to reorganize unguaranteed private credits falling due in the period of the reorganization on terms comparable to those covering government or government-guaranteed credits;

(c) the debtor country agrees to implement an economic program designed to respond to the underlying conditions and to overcome the deficiencies which led to the need for reorganizing debt-service payments.

4. The amounts of principal and interest to be reorganized should be agreed upon only after a thorough analysis of the economic situation and the balance-of-payments prospects of the debtor country.

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5. The payments that are reorganized normally should be limited to payments in arrears and payments falling due not more than one year following the reorganizing negotiations.

The foregoing is the text of an action of the National Advisory Council on International Monetary and Financial Policies approved on January 6, 1978.

Robert S. Watson
Secretary

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References:
NAC Document 78-1
Staff Committee Minutes 78-1

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DEPARTMENT OF STATE

BRIEFING PAPER

Current Economic Issues in US-Canadian Bilateral Relations

Introduction and Setting

United States ties with Canada are more extensive than with any other foreign country. While bilateral relations at the present time are generally good, there are several serious irritants. The most important, in the Canadian view, is the US failure to approve the fisheries and boundaries treaties signed in early 1979. On the US side there is growing concern about the Canadian energy program announced in October.

Canadians are sensitive to the asymmetry in their relationship with the United States, given Canada's dependence on the U.S. and the disparities in population and economic power. They have reacted negatively to statements by Americans favoring the creation of a North American common market or free trade area. In the Canadian view, such an arrangement would drain Canadian energy resources, and Canadian markets would be invaded by American goods.

Canadians today are preoccupied by the national unity issue. Quebec separatism has receded for the time being. Potentially more serious centrifugal forces are found today in western Canada, centering on energy-rich Alberta. Western Canadians have long believed themselves to be disadvantaged in their relationship with Ottawa. Ottawa's oil pricing policy, which requires Alberta to sell its oil for about half the world price, has led to growing dissatisfaction in the West.

Bilateral Energy Issues

National Energy Program: On October 28 the Canadian Government announced a far-reaching National Energy Program (NEP), designed to maximize Canadian ownership and control of the energy industry, and to reduce oil imports primarily through a switch to natural gas and increased conservation efforts. The NEP contains a number of measures that will discriminate against U.S. investment and trade and will probably reduce energy exploration and production in Canada. The principal elements are the Canadianization of energy investment by tax and other measures that discriminate against non-Canadian firms and can be expected to reduce their value; discriminatory trade measures including mandatory use of Canadian goods and services in certain energy programs at the expense of U.S. exports; and below world market oil pricing that could retard energy conservation and development in Canada with adverse effects on the global energy balance.

We informed the Canadian Government on November 7 on a preliminary basis of our serious concerns regarding elements of the NEP, emphasizing both the energy policy and discriminatory aspects of the program; and expect to meet with them again in mid-December.

Alaskan Gas Pipeline: This 4800-mile, privately financed project designed to carry natural gas from Prudhoe Bay oil field has received priority support from both the Canadian and U.S. Governments. After considerable delay the project is now underway. Canada has a large stake in this project and is very sensitive to delays. Senior Canadian officials have publicly warned that a lack of U.S. follow-through on the assurances we have given Canada would be very serious.

Natural Gas Pricing: The U.S. imports 5 percent of its national gas from Canada, primarily for mid-west and far-west markets. Canada's pricing formula is linked to the cost of imported crude oil for its eastern provinces, resulting in a price increase from $2.16 per million btu in January 1979 to $4.47 now. This rise, coupled with the availability of cheaper alternatives in U.S. markets, particularly residual fuel oil, has resulted in a substantial drop in Canadian gas sales in the U.S.

On November 14 the Canadian Government extended the $4.47 price in effect since last April. Canada is now reviewing possible adjustments to its contentious pricing formula. Further consultations on bilateral gas trade will be required.

Bilateral Investment Issues

No feature of U.S.-Canadian economic relations is so charged with emotion as U.S. direct investment in Canada. Canada created the Foreign Investment Review Agency (FIRA) in 1974 in response to concerns about the degree of U.S. corporate control over domestic industry. FIRA screens mergers and acquisitions by foreign firms in Canada as well as new investments. The principal criterion for approval is whether the proposed investment is of "significant benefit to Canada". FIRA has approved about 90 percent of all investment applications, but often with significant performance requirements, such as minimum Canadian employment targets, increased R&D in Canada, and local sourcing. Such performance requirements levied on investors are a matter of concern to us. We are also troubled by the obvious departure from national treatment.

Canada plans legislation to extend the mandate of FIRA to already existing investment. While details have not been made public, it appears that existing foreign investment in

Canada may be made to demonstrate "significant benefit to Canada" or face divestiture. The potential for friction in that event is large.

East Coast Fisheries and Boundary Treaties

The Fisheries Agreement provides for joint management and sharing of the fisheries resources of the Gulf of Maine. The Boundary Treaty, linked to it, provides for arbitration of the off-shore boundary. The treaties have been stalled in the Senate for 18 months by the New England Congressional Delegation. Canadian Foreign Minister MacGuigan has called US failure to ratify the treaties Canada's most serious issue with any nation. Its resolution early in the new Administration would be viewed as a very positive development in Canada. Failure to resolve the issue promptly risks serious bilateral friction when fishing begins again in the Spring, as well as long-term damage to the fishery by overfishing.

Bilateral Trade Issues

U.S./Canadian Automotive Agreement: This sectoral free trade agreement has been in effect since 1965. The Canadians are concerned about their persistent deficit and about receiving their "fair share" of new investment and R&D expenditures. The U.S. is concerned about duty remission schemes intended to promote Canadian exports of auto parts, possible expansion of FIRA review to U.S. auto investments in Canada, and the use of special incentives to induce new automotive investments. Formal consultations on the Automotive Agreement are currently underway.

"Buy National" Legislation: Canada has complained about the 10% preference to U.S. suppliers in federally funded transportation projects (under the provisions of the Surface Transportation Act of 1978) as both discriminatory and in violation of the Automotive Agreement. Canada has proposed various remedies but has not offered adequate reciprocity. Canada is also concerned about "Buy America" legislation at the state level. We, too, oppose such laws, but once enacted, they are not subject to federal override.

While Canada has no Buy Canada Act, it accomplishes the same purpose through regulations and policy guidelines. Moreover, like the U.S., the Canadian federal government lacks authority over provincial actions in this area.

Environmental Issues

The Great Lakes Water Quality Agreement of 1978 has led to improvement in waste water treatment facilities in the Great Lakes basin. Pollution of international rivers

and protection of pristine areas are of continuing concern. The Garrison irrigation project in North Dakota has long been opposed by Canadians fearing irreparable damage to their fresh water fisheries.

The U.S. and Canada signed a Memorandum of Intent on August 5, 1980, looking toward a formal agreement to control transboundary air pollution, including acid rain. Five work groups are now assembling information on pollution research, monitoring, control technology and control strategies. Formal negotiations are expected to begin in mid-1981. A major Canadian objective will be to abate pollution from Ohio Valley industry flowing northward into Canada. A U.S. goal will be to achieve Canadian agreement to pollution controls on a series of large coal-fired power plants in border areas.

Grains Embargo

On November 28, Canada announced its decision to resume normal grains exports to the USSR. The statement was ambiguous. It reiterated that Canada does not intend to take advantage of the export policies of the U.S. or the other exporters, or export more grain to the USSR than would have been sold in the absence of the partial embargo. At the same time, Canada announced the sale of 2.1 MMT of grain to the USSR, bringing total sales for this crop year to about 5.5 MMT, a level which has not been reached since the 1972/73 crop year. We are seeking clarification but do not expect a reversal of the new policy.

Bilateral Tax Treaty

On September 26, the U.S. and Canada signed a comprehensive tax treaty. Although the treaty is expected to receive widespread support in the U.S., there are several areas of controversy. U.S. border TV broadcasters oppose a Canadian law which denies to Canadians tax deduction of expenses for advertising in foreign media. The braodcasters have linked this issue with a possible U.S. relaxation of restrictions on the tax deductibility of conventions held abroad. The tax treaty lifts the U.S. restrictions, in effect removing this counter from the bargaining table. Broadcasters may seek to block the treaty as a result. To overcome opposition from broadcasters and others, strong support will be needed for the ratification of the treaty.

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BRIEFING PAPER

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Transition Paper - Poland: The Economic Dimension

Statement of the Issue

Poland, though atypical in some important respects, is a stark example of the economic/political policy dilemma of the present era: policies necessary to bring about and ensure long-term economic stability -- which thus are the basis of lasting political stability -- are often in fundamental conflict with short-term political and economic imperatives. In Poland, political pressures in the early 1970s for unsustainable programs to increase consumption and expand the industrial base led to accelerating economic destabilization over the decade. Attempts to rectify the situation were blocked by political backlash, the last example of which is the widespread strikes of this summer and fall; while the resulting quantum leap in political liberalization represents for the West a progressive development, income gains to workers and production losses only hasten and worsen Poland's economic deterioration.

Economic stabilization in Poland is vital to our long-term economic and political objectives; yet it could, by reducing income and consumption in the short-term, threaten Poland's political liberalization. The new Polish regime faces this argonizing dilemma, and so do we. For the U.S. the policy issue is whether and how we assist the Poles in their economic plight while preserving the political gains for the West represented by the Polish liberalization. Our policy problem is compounded because Poland is a member of CEMA and the Warsaw Pact, and is not a member of the IMF.

Background

Poland's economic/financial problems are a result of policies adopted in the early 1970s to modernize industry and raise living standards. The strategy involved massive imports of Western technology and equipment financed mainly

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by western credits. This imported capital equipment was to add to export capacity and generate additional receipts to pay off the debt. In conjunction, the Polish Government rapidly increased meat supplies at stable prices, and intended to expand agricultural production to meet rising fodder requirements without major grain imports.

The strategy proved counterproductive. Growth and consumption soared, but the export surge failed to materialize and grain production remained stagnant. The balance of payments with the West deteriorated badly after 1976 as any progress in reducing imports or expanding exports has been outweighed by rising service on the growing external debt. The government's latest attempt to reduce the trade imbalance led to the September strikes. The economic gains from these strikes in turn will worsen the trade balance by over $600 million this year and by a larger amount in 1981.

Poland's external debt grew from $11.5 billion in 1976 to $21 billion at the end of 1979. Debt service climbed from $1.9 billion in 1976 to $6.3 billion in 1979; it amounts to $7.9 billion in 1980, rises to $10.4 billion in 1981, and to $10.7 billion in 1982. (See attached table for detailed breakdown).

U.S. exposure is relatively small ($1.4 billion owed U.S. private banks and $1.8 billion owed the USG); we are fifth among creditor countries. However, our predominant use of CCC credits and guarantees, with their three-year payback terms, has put the U.S. first among creditors in terms of debt service due in 1981.

The Poles have managed to finance their deficit through 1980 by various ad hoc means: tied trade credits; refinancing or rescheduling payments due European official creditors; and refinancing by private banks. The picture is more desperate in 1981; we estimate a net financing need of about $4.3 billion. Whether the Poles will be able to finance this in their usual ad hoc way is highly problematical; some form of debt relief is very likely to be necessary. The alternative, default, would be worse.

Time Constraint

The first few months of 1981 will require decisions as to whether and how we help Poland alleviate its financial crunch. By mid-year, Poland might have to default in the absence of some form of debt refinancing or rescheduling. The Polish government has requested substantial assistance. They will renew their request to the new administration. Moreover, the Western Europeans are consulting with us on possible assistance efforts -- they have all been asked for help by the Poles -- and will be pressing for decisions.

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What We Are Doing and Why

The Poles requested an assistance package consisting of: 1) $3 billion in concessional credits over three years; 2) deferral of payments due in 1981; 3) an additional $200 million in CCC guarantees in FY 1981; and 4) an increased fishing allocation. We have not replied formally, but have indicated informally that it would be extremely difficult to provide any large concessional credit and to increase the fishing allocation. Deferring CCC repayment and providing additional CCC guarantees have been considered as possible interim measures to help get the Poles through the early months of 1981 and provide a positive political signal. But for now we will not proceed.

We are also considering whether and how we should handle the almost inevitable restructuring of Polish debt. There are two options:

-- to stay aloof, in effect refusing to take part in any formal debt rescheduling, and allowing the Europeans and the Soviets to bear the burden.

-- to participate in a formal debt rescheduling, in a coordinated but not necessarily multilateral context, with the other creditors.

The first option would entail the active cooperation of the Europeans, as they would have to continue to undertake a series of ad hoc bilateral reschedulings and/or refinancings of their credits to Poland. It would put pressure on the Soviets to pick up a larger part of the burden. We would avoid the risk of offending Soviet sensitivities about U.S. interference in Warsaw pact countries, and also avoid extremely thorny problems involved in a formal rescheduling for Poland. But this policy approach might not serve our political interest as it could be seen as a lack of support for the political liberalization in Poland. It also could sour relations with the Western Europeans, as we will be seen as not sharing the burden of what they believe is a vital issue to the Western alliance as a whole.

The second option better serves our political objectives and would meet the expectations of our West Europeans allies. However, it creates difficult and costly precedents for two traditional pillars of our debt rescheduling policy, over which Congress keeps a zealous watch.

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We always insist that there be comparability among creditors, normally by rescheduling multilaterally -- thus requiring all official creditors to agree on terms -- and requiring in the

multilateral agreement that the debtor will seek comparable terms from private creditors. In the Polish case, comparability is complicated by the USSR being a significant creditor; moreover for political reasons Poland probably would refuse a multilateral rescheduling. A series of bilateral reschedulings which are closely coordinated might serve to address the comparability standard, and it would find acceptance with the Poles. But a coordinated bilateral approach will make comparability among Western creditors harder to achieve, and probably it will be less than exact, when creditors have differing degrees of interest in Poland's political liberalization. In any case, Soviet comparability is unlikely.

More difficult is the question of a stabilization program, normally effected through the IMF. The options on this boil down to:

-- a waiver of such a program for Poland;

-- some sort of self imposed stabilization program by the Poles with targets monitored by the creditors. This could be cosmetic, linking the inevitable future reschedulings only loosely to hitting the targets. Or it could tie future reschedulings to the targets.

-- a requirement that Poland join the IMF, either before a rescheduling, or as a condition for any further rescheduling beyond the first year. In the latter case, there could be a waiver, or a self-imposed stabilization program, in the interim period.

A meaningful stabilization program, however, under IMF aegis or not, could conflict with our immediate political objectives by fueling worker discontent and could be exploited by the Soviets and others as Western intervention. On the other hand, without such a program, the economic/financial situation will continue to deteriorate. The longer stabilization is delayed, the greater the assistance burden on the West (and on the Sovets) to prevent economic and political disruption, and the higher the price tag in both economic and political terms -- to the West, the Poles, and the Soviets -- when stabilization is finally undertaken, as it must ultimately be. In that sense, a meaningful program if it could be managed sooner rather than later would serve our political interest in preseving the new element of pluralism and liberalism in the Polish polity.

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Polish Hard Currency Debt and Debt Service
(U.S. $ Millions)

	1976	1977	1978	1979	Proj. 1980
Total Debt: Gross	11,483	13,967	17,844	21,000	23,500
Net	10,680	13,532	16,972	20,130	22,500
of which					
Commercial Debt	9,159	10,393	13,430	15,805	17,687
Banks	7,947	9,274	12,441	13,859	15,509
Promisory Notes	1,080	1,090	960	1,000	1,000
Other (net)	132	29	29	946	1,178
Government Backed Debt	2,324	3,574	4,414	5,195	5,813
Guaranteed Export Credits	1,849	2,921	3,700	4,354	4,872
Other	475	653	714	841	941
Total Debt Service	1,868	2,887	4,336	6,250	7,897
Principal	1,213	1,968	2,869	4,500	5,697
Interest	655	919	1,467	1,750	2,200
Due to Private Creditors	1,401	2,165	3,252	4,687	5,922
Due to Official Creditors	467	722	1,084	1,563	1,975